

Message Text

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PAGE 01 STATE 069738 POSS DUPE
ORIGIN L-03

INFO OCT-01 EUR-12 EB-08 ISO-00 SSO-00 NSCE-00 INRE-00
USIE-00 SOE-02 AID-05 CEA-01 CIAE-00 COME-00
DODE-00 DOE-11 H-01 INR-10 INT-05 NSAE-00 OMB-01
PM-05 OES-07 SP-02 SS-15 STR-07 TRSE-00 ACDA-12
/108 R

DRAFTED BY L/EUR:JCROOK:SMW
APPROVED BY EB/ORF:SBOSWORTH
EUR/CAN:JROUSE
FERC:OSMITH

-----035556 180259Z /62

O 180031Z MAR 78
FM SECSTATE WASHDC
TO AMEMBASSY OTTAWA IMMEDIATE

C O N F I D E N T I A L STATE 069738

E.O. 11652: GDS

TAGS: ENRG, CA

SUBJECT: CAPITAL COST OF NORTHERN GAS PIPELINE

REF: OTTAWA 1284

1. CANADIAN PROPOSAL TRANSMITTED IN OTTAWA 1284 HAS BEEN
INTENSIVELY REVIEWED BY DOE (ADGER), F.E.R.C. (SMITH) AND
DEPARTMENT. EMBASSY REQUESTED TO MAKE FOLLOWING POINTS TO
GOC, AND TO DELIVER DRAFTS OF U.S. SIDE LETTER AND PRO-
POSED EXCHANGE OF NOTES. EMBASSY SHOULD NOTE THAT U.S.
VIEWS SIDE LETTER AS NECESSARY FOR U.S. AGREEMENT TO
AMENDMENT OF ANNEX III.

2. WE BELIEVE STABBACK LETTER PROVIDES A BASIS FROM WHICH
AGREEMENT CAN BE REACHED, AND WE ARE PREPARED TO PROCEED
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CONFIDENTIAL

PAGE 02 STATE 069738 POSS DUPE

WITH AN EXCHANGE OF NOTES TO INCORPORATE A "TECHNICAL
ADDENDUM" INTO THE AGREEMENT, IF SEVERAL BASIC UNDERLYING
PREMISES CAN BE SPELLED OUT FOR THE RECORD. THE PROPOSED
EXCHANGE OF NOTES AND RELATED U.S. SIDE LETTER REFLECT
THIS APPROACH.

3. WE REGRET APPARENT CANADIAN MISUNDERSTANDING ABOUT

INTENTION UNDERLYING MARCH 10 U.S. PROPOSAL. U.S. TEXT OF THE ADDENDUM WAS NOT INTENDED TO PLACE AN ABSOLUTE CAP ON

MONITORING COSTS INCURRED BY CANADIAN COMPANIES, SINCE THIS IS A MATTER FOR CANADIAN REGULATORY JURISDICTION. INSTEAD, U.S. PROPOSAL WAS INTENDED TO ESTABLISH THAT MONITORING COSTS INCLUDED IN THE FILED CAPITAL COSTS OF ANNEX III (WHICH WOULD PRESUMPTIVELY BE APPROVED BY U.S. REGULATORY AUTHORITIES FOR PASS-THROUGH TO U.S. CONSUMERS) WOULD NOT EXCEED \$36 MILLION.

4. THE U.S. IS RELUCTANT TO ACCEPT STABBACK'S POINT THAT ALL MONITORING COSTS ARE PERMITTED, AND BELIEVES THAT CANADIAN FORMULATION OF THE ADDENDUM WOULD PREJUDICE OUR POSITION SINCE IT WOULD INCLUDE ALL MONITORING COSTS AS "NORMAL PIPELINE COSTS." . WHILE WE RECOGNIZE THAT MONITORING COSTS PAID BY CANADIAN COMPANIES CANNOT BE LIMITED, U.S. REGULATORY AUTHORITIES STATE THAT MONITORING COSTS IN EXCESS OF \$36 MILLION WOULD BE GIVEN CRITICAL SCRUTINY IN DETERMINING WHETHER IT IS APPROPRIATE TO PASS SUCH COSTS THROUGH TO U.S. CONSUMERS. ACCORDINGLY, THE U.S. WOULD WANT THE RECORD TO CLEARLY REFLECT THAT THE FILED CAPITAL COSTS FOR 56-INCH PIPELINE IN THE AMENDED ANNEX III INCLUDE THE SUM OF \$36 MILLION FOR MONITORING COSTS. FURTHER, IN REVIEWING MONITORING CHARGES, U.S. REGULATORY AUTHORITIES WOULD EXPECT THAT THESE CHANGES

CONFIDENTIAL

CONFIDENTIAL

PAGE 03 STATE 069738 POSS DUPE

WOULD BE ALLOCATED AMONG THE 9 ZONES IN CANADA IN REASONABLE PROPORTION TO THE ACTUAL COST OF CONSTRUCTION IN EACH ZONE.

5. SHOULD MONITORING COSTS EXCEED \$36 MILLION, OR SHOULD THEY BE APPORTIONED OTHER THAN IN REASONABLE PROPORTION TO CONSTRUCTION COSTS, THE U.S. WOULD INVOKE CONSULTATIONS UNDER SECTION 11(A) OF THE AGREEMENT ON PRINCIPLES "TO CONSIDER WHETHER SUCH CHARGES SHOULD BE INCLUDED IN THE COST OF SERVICE".

6. CANADIAN UNDERSTANDING ON THESE POINTS IS FUNDAMENTAL TO U.S. ACCEPTANCE OF THE NEW SCHEDULE OF FILED CAPITAL COSTS FOR THE 56-INCH LINE. WE WOULD PROPOSE TO SPELL THEM OUT IN A LETTER TO BE SIGNED BY THE AMBASSADOR CONTEMPORANEOUS WITH AN EXCHANGE OF NOTES AMENDING THE ANNEX.

7. TEXT OF POSSIBLE U.S. SIDE LETTER TO EXCHANGE OF NOTES:

IN CONNECTION WITH THE AGREEMENT CONCLUDED TODAY TO EFFECT A TECHNICAL ADDENDUM TO ANNEX III OF THE AGREEMENT ON PRINCIPLES APPLICABLE TO THE NORTHERN GAS PIPELINE, I WISH

TO EXPRESS TWO UNDERSTANDINGS OF THE U.S. SIDE.

FIRST, WE UNDERSTAND THAT THE SPECIFIED FILED CAPITAL COSTS IN ANNEX III, AS AMENDED, INCLUDE THE AMOUNT OF \$36 MILLION FOR MONITORING CHARGES.

SECOND, WE ANTICIPATE THAT SUCH MONITORING CHARGES WILL BE ALLOCATED AMONG ZONES 1-9 OF THE PIPELINE IN CANADA IN SUBSTANTIAL PROPORTION TO THE ACTUAL CONSTRUCTION COSTS IN EACH ZONE

SHOULD MONITORING CHARGES EXCEED \$36 MILLION, OR NOT BE ALLOCATED AMONG ZONE 1-9 OF THE PIPELINE IN CANADA IN SUBSTANTIAL PROPORTION TO THE ACTUAL CONSTRUCTION COSTS IN

CONFIDENTIAL

CONFIDENTIAL

PAGE 04 STATE 069738 POSS DUPE

EACH ZONE, THE UNITED STATES WILL INVOKE CONSULTATIONS UNDER SECTION 11(A) OF THE AGREEMENT TO CONSIDER "WHETHER SUCH CHARGES SHOULD BE INCLUDED IN THE COST OF SERVICE" ULTIMATELY TO BE PAID BY U.S. CONSUMERS.

SINCERELY,

THOMAS O. ENDERS
AMBASSADOR, END TEXT OF SIDE LETTER.

8. CANADIAN NOTE:

I HAVE THE HONOR TO REFER TO THE AGREEMENT BETWEEN CANADA AND THE UNITED STATES OF AMERICA ON PRINCIPLES APPLICABLE TO A NORTHERN NATURAL GAS PIPELINE, SIGNED AT OTTAWA ON SEPTEMBER 20, 1977. THE NATIONAL ENERGY BOARD, AS THE APPROPRIATE CANADIAN REGULATORY AUTHORITY UNDER ARTICLE 10 OF THE AGREEMENT, HAS DECIDED TO APPROVE THE USE OF 56-INCH PIPE FOR THE SECTION OF THE NORTHERN NATURAL GAS PIPELINE BETWEEN WHITEHORSE, YUKON AND CAROLINE JUNCTION, ALBERTA. IN LIGHT OF THIS DECISION, I HAVE THE HONOR TO PROPOSE A TECHNICAL ADDENDUM TO ANNEX III OF THE AGREEMENT:

"THE CAPITAL COSTS SPECIFIED IN ANNEX III SHALL BE DEEMED TO INCLUDE ALL NORMAL PIPELINE COSTS INCURRED IN CONSTRUCTING GAS PIPELINE FACILITIES IN CANADA, EXCEPT THOSE SPECIFICALLY EXCLUDED IN THE PROVISIONS OF THE ANNEX, AND INCLUDE SUCH ITEMS AS AN ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION. THE ANNEX III CAPITAL COSTS SHALL ALSO INCLUDE AN ALLOWANCE ON AND RECOVERY OF REGULATORY MONITORING COSTS.

"THE FOLLOWING ADDITIONS SHALL BE MADE TO THE TABULATIONS

CONFIDENTIAL

CONFIDENTIAL

PAGE 05 STATE 069738 POSS DUPE

CONTAINED THEREIN:

(A) TO THE TABLE CAPTIONED: "FILED CAPITAL COST" ESTIMATES FOR THE PIPELINE IN CANADA (MILLIONS OF CANADIAN DOLLARS) THE PIPELINE IN CANADA (ZONES 1-9), INSERT AS LINE FOUR THE FOLLOWING PHRASE:

"OR 56" - 1080 LB. PRESSURE PIPELINE - 4,325

FOOTNOTE 1, SUBPART (B) TO SAID TABLE SHALL BE MODIFIED TO READ IN ITS ENTIRETY--

(B) A 1260 PSI, 48-INCH; OR 1680 PSI, 48-INCH; OR 1120 PSI, 54-INCH; OR 1080 PSI, 56-INCH LINE FROM THE POINT OF POSSIBLE INTERCONNECTION NEAR WHITEHORSE TO CAROLINE JUNCTION.

"(B) TO THE TABLE CAPTIONED: FILED CAPITAL COSTS FOR THE PIPELINE IN CANADA, ADD AN ADDITIONAL COLUMN, AS FOLLOWS:

56"
1080 PSI
DOLS MILLION

(CANADIAN)

707
817
874
427
850
236
126
83
205

CONFIDENTIAL

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PAGE 06 STATE 069738 POSS DUPE

4325"

IF THIS PROPOSAL IS ACCEPTABLE TO YOUR GOVERNMENT, I HAVE THE HONOR TO PROPOSE THAT THIS NOTE (WHICH IS EQUALLY AUTHENTIC IN BOTH ENGLISH AND FRENCH) AND YOUR REPLY TO THAT EFFECT SHALL CONSTITUTE AN AGREEMENT BETWEEN OUR TWO GOVERNMENTS TO ADD A TECHNICAL ADDENDUM TO ANNEX III OF

THE AGREEMENT ON PRINCIPLES APPLICABLE TO A NORTHERN
NATURAL GAS PIPELINE." END TEXT OF CANADIAN NOTE.

U.S. REPLY

I HAVE THE HONOR TO REFER TO YOUR NOTE NO. OF TODAY'S
DATE, PROPOSING A TECHNICAL ADDENDUM TO ANNEX III OF THE
AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND CANADA
ON PRINCIPLES APPLICABLE TO A NORTHERN NATURAL GAS PIPELINE.

THE GOVERNMENT OF THE UNITED STATES ACCEPTS THE PROPOSAL
CONTAINED IN YOUR NOTE UNDER ACKNOWLEDGEMENT, AND AGREES
THAT YOUR NOTE TOGETHER WITH THIS REPLY SHALL CONSTITUTE
AN AGREEMENT ON A TECHNICAL ADDENDUM TO ANNEX III OF THE
AGREEMENT ON PRINCIPLES. END TEXT OF U.S. REPLY.

9. WE APPRECIATE CANADIANS WISH TO MOVE PROMPTLY, AND WILL
TRY TO ACCOMMODATE. CIRCULAR 175 REQUESTING MR. COOPER'S
AUTHORIZATION TO AMEND THE AGREEMENT IS BEING PREPARED.
HOWEVER, WE BELIEVE THAT WE MUST ALSO ADVISE INTERESTED
CONGRESSIONAL STAFFS BEFORE CONCLUDING THE EXCHANGE OF
NOTES. NEVERTHELESS, IF CANADIANS ACCEPT U.S. UNDER-
STANDING OF THE AGREEMENT, IT IS FEASIBLE TO WRAP THIS UP
BEFORE PARLIAMENT GOES ON ITS EASTER RECESS. VANCE

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: COSTS, PIPELINES, JOINT VENTURES, DIPLOMATIC NOTES
Control Number: n/a
Copy: SINGLE
Draft Date: 18 mar 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978STATE069738
Document Source: CORE
Document Unique ID: 00
Drafter: JCROOK:SMW
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780120-0360
Format: TEL
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780351/aaaabrfq.tel
Line Count: 247
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 4a9f7cc4-c288-dd11-92da-001cc4696bcc
Office: ORIGIN L
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 OTTAWA 1284
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 08 jul 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3282782
Secure: OPEN
Status: NATIVE
Subject: CAPITAL COST OF NORTHERN GAS PIPELINE
TAGS: ENRG, CA, US
To: OTTAWA
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/4a9f7cc4-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014